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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 213

ALLIED CHEMICAL & DYE CORPORATION,
Petitioner,

DENIS J. McMAHON, Individually and as District Director of Internal Revenue for Lower Manhattan, New York,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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ALLIED CHEMICAL & DYE CORPORATION,
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v.

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Victor Futter, on behalf of Allied Chemical & Dye Corporation, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above case on April 7, 1958.

Opinions Below

The opinion and judgment of the United States District Court for the Southern District of New York and of the United States Court of Appeals for the Second Circuit are printed in the Appendix and are reported, respectively, at 156 F. Supp. 275 and 253 F. 2d 663.

Jurisdiction

The judgment of the court of appeals was entered on April 7, 1958 (Appendix, *infra*, p. 1a). A petition for rehearing was denied on April 28, 1958 (Appendix, *infra*, p. 3a). The jurisdiction of this Court is invoked under 28 U. S. C. sec. 1254(1).

Question Presented

Whether the court of appeals erred in holding that petitioner, in a 1950 corporate recapitalization, dedicated capital for the first time so as to be subject to the documentary stamp tax on corporate issues imposed by section 1802(a) of the Internal Revenue Code of 1939, although no increase in its legal capital then occurred under the state law of its domicil. Put differently, the question is whether the concept of dedicated capital is to be given a different meaning under section 1802(a) than under the law of the state in which a corporation is incorporated.

Statute Involved

The Internal Revenue Code of 1939, 53 Stat. 195, 196, 55 Stat. 707, 61 Stat. 921, provides in pertinent part as follows:

Internal Revenue Code of 1939

Sec. 1800. *Imposition of tax*

There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections. 53 Stat. 195.

Sec. 1802. *Capital Stock* (and similar interests)

(a) *Original issue.* On each original issue, whether on organization or reorganization, of shares or certificates of stock, or of profits, or of interest in property or accumulations, by any corporation, or by any investment trust or similar organization (or by any person on behalf of such investment trust or similar organization) holding or dealing in any of the instruments mentioned or described in this subsection or section 1801 (whether or not such investment trust or similar organization constitutes a corporation within the meaning of this title), on each $100 of par or face value or fraction thereof of the certificates issued by such corporation or by such investment trust or similar organization (or of the shares where no certificates were issued), 11 cents: *Provided*, That where such shares or certificates are issued without par or face value, the tax shall be 11 cents per share (corporate share, or investment trust or other organization share, as the case may be), unless the actual value is in excess of $100 per share; in which case the tax shall be 11 cents on each $100 of actual value or fraction thereof of such certificates (or of the shares where no certificates were issued), or unless the actual value is less than $100 per share, in which case the tax shall be 3 cents on each $20 of actual value, or fraction thereof, of such certificates (or of the shares where no certificates were issued): *Provided further*, That where such certificates (or shares, where no certificates are issued) are issued in a recapitalization, the tax payable shall be that proportion of the tax computed on such certificates or shares issued in the recapitalization that the amount dedicated as capital for the first time by the recapitalization, whether by a transfer of earned surplus or otherwise, bears to the total par value (or actual value if no par stock) of such certificates or shares issued in the recapitalization. The stamps representing the tax imposed by this subsection shall be attached to the stock books or corresponding records of the organization and not to the certificates issued.

Statement.

The Internal Revenue Code of 1939 imposes a documentary stamp tax on each original issue of shares of stock by any corporation, based on the value of the stock certificate. It further provides that where such certificates are issued in a recapitalization, the tax payable is determined by reference to "the amount dedicated as capital for the first time by the recapitalization, whether by transfer of earned surplus or otherwise". 26 U. S. C. (INT. REV. CODE 1939) section 1802(a). No tax is payable in a recapitalization if there is no dedication of additional capital.

Petitioner, a New York corporation, seeks the review of a judgment of the United States Court of Appeals for the Second Circuit which, "on the opinion of District Judge Walsh", affirmed the district court's dismissal of the complaint and entry of summary judgment for the Collector of Internal Revenue; the jurisdiction of the district court was founded on 28 U. S. C. sec. 1340. The Collector determined that, in the course of a stock-split in 1950, petitioner dedicated capital notwithstanding the fact that both before and after the split petitioner's legal capital was $113,043,675., an amount fixed by the law of New York. The events of 1950 may be understood against the following background.

Petitioner was incorporated in December 1920 under the laws of New York (Stipulation of Facts, hereinafter "Stipulation", Par. 1). As a New York corporation authorized by charter to issue no par stock as well as par value preferred stock, petitioner complied with the New York Stock Corporation Law, section 19, as then in force, which required a corporation intending to issue no par stock to state in its Certificate of Incorporation:

> "* * * the amount of capital with which the corporation will carry on business,"

Section 19—as it then existed—required that the capital of a corporation issuing both par and no par stock be not less than the sum of—

> "• • • the total par value of the authorized preferred stock; and
>
> "• • • a sum equivalent to Five Dollars for every share authorized to be issued other than such preferred stock."

Under this statute, it is to be noted, capital is computed with reference to authorized rather than issued shares. It is to be further noted that the figure of Five Dollars, the unit dollar value allocated to each no par share in the computation of statutory capital, is a completely arbitrary amount bearing no relation to book value, market value or any other accepted value for a per share evaluation.

Taxpayer's first amended Certificate of Incorporation, which became effective March 8, 1921, authorized the following amounts of stock:

973,264 shares of preferred stock of a par value of $100 per share;

3,143,455 shares of common stock without par value.

Based on this number of shares authorized by its charter, it was mandatory that petitioner state therein as its capital, the sum of $113,043,675. Petitioner's charter accordingly stated that its capital was $113,043,675. (Stipulation, Par. 2).

By 1924, petitioner had issued 392,849 shares of preferred stock of $100 par value, and 2,178,109 shares of no par common stock; as the issue tax on the no par common stock was based on the "actual" value of that stock (not its stated value under New York law) petitioner paid a federal documentary stamp tax on these shares and on the preferred stock in an amount based on an aggregate value *exceeding its charter capital.* (Stipulation, Par. 4). In

accordance with the above cited statutes, which required that petitioner's capital be maintained at the stated charter figure, petitioner's capital account in that year reflected prior issues of stock as follows:

392,849	shares of preferred stock @ $100 per share	$ 39,284,900
2,178,109	shares of no par common @ $5 per share	10,890,545
	Capital surplus	62,868,230
	Total	$113,043,675

In 1936 petitioner redeemed all its outstanding preferred stock by action of its Board of Directors, without charter amendment. Immediately thereafter, the capital account appeared (Stipulation, Par. 7; and Exhibit B):

2,401,288	shares of no par common @ $5 per share	$ 12,006,440
	Capital surplus	101,037,235
	Total	$113,043,675

Prior to 1950, former section 19 of the New York Stock Corporation Law had been changed and renumbered 12 to provide that a corporation could issue no par shares if its Certificate of Incorporation contained a statement that its capital "shall be *at least* equal to the sum of the aggregate par value of all *issued* shares having par value, plus..... dollars (the blank space being filled in with some number representing one dollar or more) in respect to every *issued* share without par value * * *" and that "There may also be included in such Certificate an additional statement that the capital shall *not be less* than.....dollars (the blank space being filled in with a number)."

On August 1, 1950 petitioner's Certificate of Incorporation was amended (Stipulation, Par. 9) to, among other things, change each of the outstanding shares of no par common into four shares of no par common in a recapital-

ization; and to change the provision regarding the capital of the corporation, in accordance with the modern form of New York Stock Corporation Law then in effect, to read as follows:

> "The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value, plus Five Dollars ($5.00) in respect to every issued share without par value, plus such amounts as, from time to time, by resolution of the Board of Directors, may be transferred thereto. The capital of the corporation shall not be less than One Hundred Thirteen Million Forty-three Thousand Six Hundred Seventy-five Dollars ($113,043,675)."

As the aggregate value of petitioner's issued shares remained less than its stated charter capital, no change in capital was effected by the recapitalization of 1950.

The 1950 recapitalization was reflected in petitioner's books of account by an increase in the "Capital Stock" account of $5 (the statutory and charter requirement) for each of the 6,642,297 additional common shares issued, and a decrease in the "Capital Surplus" account by the same amount. Petitioner's balance sheet, after the 1950 recapitalization, appeared (Stipulation, Par. 11):

Capital stock, without par value basis $5 per share—	
Issued 8,856,396 shares	$ 44,281,980
Capital surplus	68,761,695
Total.....	$113,043,675

Throughout the period described above, the New York Stock Corporation Law contained a section, now numbered 13, which read substantially as follows:

> "For the purpose of any rule of law or of any statutory provision relating to the amount of the capital of a stock corporation, the capital of any corporation authorized to issue shares without par value shall be

deemed to be an amount computed in accordance with the statements respecting its capital contained in its certificate of incorporation or other certificate filed pursuant to law, or in a special law creating the corporation; and the capital of any corporation not authorized to issue shares without nominal or par value shall be deemed to be the aggregate par value of its issued shares plus such amounts as, from time to time, may be transferred to capital by resolution of the board of directors."

Thus, throughout the period 1921-1950, petitioner's capital under New York law was $113,043,675, "for the purpose of any rule of law or of any statutory provision" relating to its "capital stock" or "capital".

Reasons for Granting the Writ

This Court's judicial discretion for granting review on writ of certiorari extends to cases in which a court of appeals has decided an important question of federal law which has not been, but should be settled by the Court. Rule 19(1)(b). In tax cases, the Court has granted the writ because of the "frequency of the use" of a provision of the Internal Revenue Code, *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 564-5 (1949), or because of the "unsettled" state of an important field of tax law, *Commissioner* v. *Jacobson*, 336 U. S. 28, 32 (1948), or because the proper construction of a Code provision was of importance to "corporate enterprise". *Bazley* v. *Commissioner*, 331 U. S. 737, 738 (1946). The instant petition presents to the Court a case involving all of these principles. In addition, as the discussion in Point II will show, the decision of the court of appeals below is in conflict with the decision of another court of appeals, a further basis for the exercise of the Court's discretionary jurisdiction. Rule 19(1)(b); *Reo Motors* v. *Commissioner*, 338 U. S. 442, 443 (1949). Finally, as developed in Point III, the court of appeals has sanctioned clear error calling for the exercise of this Court's power of supervision. Rule 19(1)(b).

I

The recapitalization proviso of section 1802(a) of I. R. C. 1939 has never been construed by this Court. Yet, the proviso has operated upon the hundreds of corporate taxpayers who, since its enactment in 1947*, have declared stock-splits or stock dividends.

The national annual incidence of stock-splits and stock dividends may be inferred from the following: Of the companies listed on the New York Stock Exchange alone, 73 split stock in 1955 and 88 split stock in 1956; 143 declared stock dividends in 1955 and 197 declared stock dividends in 1956.** In each of these instances the determination had to be made whether, as a result of the particular recapitalization, capital had been "dedicated" within the meaning of section 1802(a). Although the phrase must be construed for a federal tax purpose, the intimate legal relation subsisting between a corporation and the state of its incorporation and the fact that a corporation's "capital" in modern law is a purely legal concept of *state* limitation, BALLANTINE, CORPORATIONS (1946 rev. ed.) 479, compel the view, in petitioner's submission, that "dedicated capital" must also be characterized by state law before the federal tax may be imposed.

The proposition that petitioner's legal capital under New York law was unaffected by the 1950 recapitalization is unassailable, and is uncontested by the district court opinion or by the briefs of opposing counsel below. Rather, the lower court took the view that notwithstanding the fixity of its legal capital under local law petitioner "dedicated capital" in a federal sense when it made certain accounting entries in that year.

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* The pertinent legislative history is set out in *United States v. National Sugar Refining Co.*, 113 F. Supp. 157 (S. D. N. Y. 1953). Prior to 1947 the proviso had legal force through regulations.

** Barker, *Stock Splits in a Bull Market*, 35 HARV. BUS. REV. 72, 73 (1957); Barker, *Evaluation of Stock Dividends*, 36 HARV. BUS. REV. 99 (1958).

In 1949, petitioner's legal capital, that is, the $113 million amount which New York law segregated from other funds available for dividends, was shown as follows on its books of account:

2,401,288* shares of no par common at $5. per share	$ 12,006,440.
Capital Surplus	101,037,235.
	$113,043,675.

The so-called "Capital Surplus" account was, as the facts set forth in the "Statement" above indicate, a historical constituent of legal capital from the founding of the company; it represented assets contributed to the company; it was not a true surplus in the sense of being retained earnings arising from the operations of the company and hence available for dividends.

Immediately after the 1950 stock-split, petitioner's legal capital appeared as follows:

Capital stock, without par value, basis $5. per share—	
Issued 8,856,396 shares	$ 44,281,980.
Capital Surplus	68,761,695.
	$113,043,675.

Despite this book transfer of more than $33 million dollars to Capital Stock, petitioner's legal capital was not increased, for the constant $113 million sum was its capital "for the purpose of any rule of law". N. Y. Stock Corporation Law, Sec. 13. Nevertheless, the Collector held that, for the purposes of the federal issue tax, capital had been "dedicated". Petitioner urges that a federal definition of "dedicated capi-

* 187,189 treasury shares, eliminated in 1950, are included.

tal" independent of a prior state law characterization is an utterly artificial construct. It points to the fact that:*

> "Corporations, as creatures of local law, are governed thereby in all respects not conflicting with specific income tax provisions. State law is thus determinative as to the continuance of corporate entity after a merger under the state laws, and also as to who can act for a corporation by signing waivers and the like. Local law has also been held applicable to determine who is taxable with respect to income received in liquidation, the liability of a successor corporation for the debts of its predecessors, and the status of stock ownership in the state. *Whether the condition of the affairs of a corporation was such that it could have declared and paid a dividend depends upon the law of the state of incorporation* * * *" (Emphasis supplied).

It urges that the Court pass upon the propriety of the district court's definition finally, so that the scores of corporations which annually recapitalize may not be misguided as to the nature of their capital for purposes of the issue tax.

Petitioner's case presents this question of construction and choice of law squarely. Its posture permits absolute and final disposition of the question presented.

II

The Second Circuit's decision herein is in conflict with the fundamental assumptions of an 1802(a) decision in the Ninth Circuit.

In *Southern Pacific Co.* v. *Berliner*, 78 F. Supp. (N.D. Cal. 1948), *aff'd*, 176 F. 2d 671 (9th Cir. 1949), the common stock of Southern Pacific, then a Kentucky corporation, was originally a par value stock. A portion of this stock had been issued at a premium which, in accordance with governing Interstate Commerce Commission accounting

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* 10A MERTENS, LAW OF FEDERAL INCOME TAXATION (1948 rev. vol.) sec. 61.15; *United States* v. *Ogilvie Hardware Co.*, 330 U. S. 709 (1942).

regulations, had been carried on the books as "premium on capital stock", a separate account from that designated "capital stock". The Company converted its entire common stock into an equivalent number of shares of no par stock. In connection with the conversion, and in compliance with an ICC ruling, the "premium on capital stock" account was eliminated, and the amount previously carried therein was added to "capital stock". The question was whether, and to what extent, the issue of the new no-par value shares was taxable.*

Both the district and circuit courts held the new issue to be taxable on the ground that prior to the conversion the "premium" constituted surplus which was capable of being distributed as dividends, but that as a result of the conversion this amount became "dedicated" as "capital" for the first time. The opinion of the district court stated (78 F. Supp. 698):

> "When the corporation had only par value stock its capital stock account represented the sum total of $100 par value for each share of stock issued. The premium on capital stock represented paid-in surplus, and, under *Kentucky corporation law*, could have been distributed as dividends, a disposition that could not have been made of any part of the capital stock account. With the exchange of the par value stock for an equal number of no-par value shares and the transfer of the amount in the premium account to the capital stock account, the total amount of capital behind the shares was increased." (Emphasis supplied)

and the court of appeals held (176 F. 2d 674):

> "In short, the nature of the premium account, whether capital or surplus, is to be determined *by reference to state law* * * *. The Company does not seriously contend that the amount here carried in premium account was not, under Kentucky law, a species of surplus subject to dividend appropriations * * *"

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* The statute was construed in relation to facts occurring prior to the 1947 amendment.

III

Not only is the instant decision of importance to the many corporations which have engaged and which will engage in recapitalizations; not only is it in conflict with the decision of another court of appeals; but it is also, on its own analysis, demonstrably incorrect.

A

The courts below held that the recapitalization proviso of Section 1802 (a) uses the concept of dedicated capital in the sense of "the contribution of the stockholders to the corporation", and implicitly propose this construction as the federal rule for the definition of the concept. Assuming, *arguendo*, the correctness of the courts' analysis, it nevertheless follows that petitioner dedicated no new capital in the recapitalization of 1950.

The stipulation of facts shows that in the years 1920-1924 the property contributed to petitioner, and for which its stock was originally issued, was the stock of five other corporations. This "contribution of the stockholders to the corporation" was valued and entered on petitioner's books at $175,960,813. (Stipulation Par. 3). Petitioner paid the required stamp tax on the 1920-1924 stock issues based on a capital amount in excess of 113 million dollars, an amount derived from the face value of the issued preferred stock and the *actual* value (not a $5 statutory value) of the issued common stock. (Stipulation Par. 4). The district court, *on its own analysis*, should have held, therefore, that petitioner's originally dedicated capital was an amount exceeding the 113 million dollar figure appearing in its corporate charter, and not merely the amounts entered in its capital stock accounts (preferred and common) which never exceeded $51,291,340.* Hence, the introduction

* The high water mark of the capital stock accounts was reached in 1931 when they appeared as follows:

392,940	shares of preferred stock @ $100 per share	$39,284,900
2,401,288	shares of no par common stock @ $5 per share	12,006,440
	Total	$51,291,340

See, Stipulation Par. 6 and Exhibit B.

into the capital stock account of $33,211,485 from the capital surplus account in 1950 was a recapitalization involving capital amounts which, having been part of the amounts originally contributed to the corporation in 1921-1924, had always been constituents of petitioner's dedicated capital *and upon which original issue taxes had previously been based and collected.* Since the courts understood, even prior to the 1947 proviso, that the "same corporate capital in the hands of the same stockholder should be taxed only once, under Section 1802 (a), even though the evidence of his ownership is changed", *Crown Cork & Seal Co.* v. *United States*, 94 F. Supp. 117, 120 (Ct. Cl. 1950), and since the 1947 proviso was expressly enacted to affirm this understanding, *Idem.*, and to avoid double taxation of existing capital when new capital is dedicated in a recapitalization, *United States* v. *National Sugar Refining Co.*, 113 F. Supp. 157, 160 (S. D. N. Y. 1953), it is clear that the holding of the district court below is improper, permitting, as it does, the exaction of an issue tax based on the same capital amount for a second time, in contravention of a clear and overriding Congressional purpose.

The supervisory power of this Court must be exercised here for an additional reason. If the decision below is permitted to stand, the Court will have permitted the usurpation of law by accounting in the construction of a federal statute governing a purely legal conception: dedicated capital.

The opinion of Walsh, D. J., adopted by the court of appeals, shows that in its consideration of the nature of petitioner's capital, questionable accounting theory, independent of law, dominated its analysis. It observed:

> "Viewed *on the basis of accounting theory* this figure is completely artificial." (App. p. 11a; emphasis supplied.)

And again,

> "There is no dedication to capital *in an accounting sense* merely because state law may prevent the free

disposition of part of the surplus.'" (App. p. 15a; emphasis supplied.)

To view "capital" first in terms of accounting practice, rather than legal substance, is to reverse the proper order of analysis, for the dedication of capital is a legal act; only partial meaning is derived from an understanding of the act "in an accounting sense". Of course, the legal event of dedication may be reflected in accounting entries, and accounting entries may serve to evidence the prior occurrence of the legal event. But it is a misapplied *a posteriori* argument to establish the fact of dedication from accounting appearances, when it is initially clear that no dedication *in a legal sense* has taken place.

In *Bazley* v. *Commissioner*, 331 U. S. 737, 741 (1946) the question arose whether a tax free "recapitalization" within the meaning of the Internal Revenue Code had taken place. In determining the issue the Court, per Justice Frankfurter, held:

> "No doubt there was a recapitalization of the Bazley corporation in the sense that the symbols that represented its capital were changed, so that the fiscal basis of its operations would appear very differently on its books. But the form of a transaction as reflected by correct corporate accounting opens questions as to the proper application of a taxing statute; it does not close them. Corporate accounting *may* represent that correspondence between change in the form of capital structure and essential identity in fact which is of the essence of a transaction • • • What is controlling is that a new arrangement *intrinsically partakes* of the elements of reorganization which underlie the Congressional exemption and *not merely give the appearance of it* • • •" (emphasis supplied).*

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* Accord, Brandeis, J., in *Helvering* v. *Midland Mutual Life Ins. Co.*, 300 U. S. 216, 223, *rehearing denied*, 300 U. S. 688 (1937): "But bookkeeping entries, though in some circumstances of evidential value, are not determinative of tax liability".

Conclusion

For the foregoing reasons, it is urged that this petition for a writ of certiorari be granted and that the case be determined on its merits.

Respectfully submitted,

VICTOR FUTTER,
Attorney for Petitioner

LAWRENCE A. COLEMAN,
JOSEPH D. BECKER,
Of Counsel to Petitioner

Dated: July 23, 1958.

APPENDIX

United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 176—October Term, 1957.

(Argued March 12, 1958 Decided April 7, 1958.)

Docket No. 24681

ALLIED CHEMICAL & DYE CORPORATION
Plaintiff-Appellant,

v.

DENIS J. McMAHON, District Director of Internal Revenue for Lower Manhattan, New York,
Defendant-Appellee.

BEFORE:

CLARK, Chief Judge,

HINCKS, Circuit Judge, and BRENNAN, District Judge.

Appeal from the United States District Court for the Southern District of New York, Lawrence E. Walsh, Judge.

Plaintiff sued to recover the documentary stamp tax it had paid in the course of a 1950 recapitalization and now appeals from a summary judgment for defendant holding that the amount it then transferred from surplus to capital stock account as representing the value of newly issued common stock was an "amount dedicated as capital" under I. R. C. 1939, Sec. 1802(a), providing for the tax in question.

LAWRENCE A. COLEMAN, New York City (Joseph D. Becker on the brief), for plaintiff-appellant.

JAMES R. LUNNEY, Asst. U. S. Atty., S. D. N. Y., New York City (Paul W. Williams, U. S. Atty., New York City, on the brief), for defendant-appellee.

PER CURIAM:

Affirmed on the opinion of District Judge Walsh, D. C. S. D. N. Y., 156 F. Supp. 275.

UNITED STATES COURT OF APPEALS

For the Second Circuit

Allied Chemical & Dye Corporation,
Plaintiff-Appellant.

v.

Denis J. McMahon, District Director of Internal Revenue for Lower Manhattan, New York,
Defendant-Appellee.

Before Clark, Chief Judge, Hincks, Circuit Judge, and Brennan, District Judge.

On Petition for Rehearing.

Lawrence A. Coleman, New York City, for plaintiff-appellant.

Per Curiam:

Petition for rehearing denied.

C. E. C.
C. C. H.
U. S. C., J. J.

S. W. B.
U. S. D., J,

April 28, 1958

#120

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

ALLIED CHEMICAL & DYE CORPORATION, Plaintiff. *against* DENIS J. McMAHON, Individually and as District Director of Internal Revenue for Lower Manhattan, New York, Defendant.	CIV. 92-247

APPEARANCES:

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Opinion

WALSH, D. J.

This is an action to recover an alleged overpayment of the documentary stamp tax, in the amount of $49,817.25. Both parties move for summary judgment. Defendant's motion is granted; plaintiff's motion is denied.

The controversy grows out of a recapitalization of the plaintiff, in the year 1950, in which it issued to the holder of each share of common stock three additional shares of the same stated value. Plaintiff claims that the new stock certificates were not taxable because they were not accompanied by a dedication of additional capital. Defendant claims that they were.

Both motions are based upon a stipulation of the underlying facts.

Plaintiff, a New York corporation, was organized on December 17, 1920 to acquire the stock of five constituent companies. It issued preferred stock with a par value of $100 a share and no-par common stock with a stated value of $5 a share in a combined amount of $48,043,675.[1] This

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[1] The stamp tax was paid, as provided by law, upon the face value of the preferred stock, $37,326,400 and upon the actual value of the common, $137,086,281. This value, in turn, was fixed upon the book value of the stock of the constituent corporations for which plaintiff's stock was exchanged, approximately $174,412,681, and deducting therefrom the face value of the preferred. An additional tax was paid as more stock was issued between 1921 and 1924 to complete the acquisition of the stock of the constituent corporations.

The acquisition of all of the stock of the constituent corporations was not completed until 1924. Its value when acquired is stipulated to have been $175,960,813. The actual value of the stock acquired upon the date of incorporation does not appear in the stipulation but on January 1, 1921, fourteen days after organization, the corporation's surplus was $126,369,006. Apparently therefore the value of the original stock upon which a stamp tax was paid was approximately $174,412,681, which is the sum of the surplus and the capital stock accounts.

amount was entered upon its books in its capital stock account.

In March, 1921 plaintiff's certificate of incorporation was amended to state its total capital in the amount of $113,043,675. This was to conform with the then existing New York statute which required corporations to state their capital upon the basis of the stated value of their *authorized* stock rather than *issued* stock.[2] No new stock was issued. The surplus account was divided into two accounts, "capital surplus" and "further surplus". The capital surplus account was fixed at the difference between the capital stock account, and the amount stated as capital in the certificate of incorporation $113,043,675. No tax was paid as the result of this transaction.

In 1930 and 1931 plaintiff issued to each holder of twenty shares one additional share of common stock with a stated value of $5 a share. The capital stock account was increased to show the addition of the newly issued shares at this stated value. The capital surplus account was reduced by the same amount so that it continued to maintain the difference between the total of the capital stock account and the amount of $113,043,675 stated as capital in the certificate of incorporation.[3] The stipulation of facts does not disclose whether a stamp tax was paid.

In 1936 the entire issue of preferred stock was retired. Although the stipulation of facts is silent as to how this was accomplished, apparently the holders of this stock were

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[2] New York Stock Corporation Law § 19 (now § 12). On May 11, 1921, a few weeks later, this statute was amended to permit the stated value of a corporation to be based upon *issued* rather than *authorized* shares and it has continued to so provide to date.

[3] Plaintiff, until 1950, never took advantage of the 1921 change in the New York statute which would have permitted it to amend its certificate of incorporation to restate capital on the basis of *issued* shares rather than *authorized* shares.

paid off in cash. The capital stock account was reduced by the aggregate par value of the preferred and this reduction was apparently offset by a reduction of the cash account. At the same time it became necessary to increase the capital surplus account so that it would continue to express the difference between the reduced capital stock account and $113,043,675, the amount stated as capital in the certificate of incorporation. This was done by transferring from "Further Surplus" an amount equal to the par value of the retired stock.

On August 1, 1950 the instant recapitalization occurred, three additional shares of stock with a stated value of $5 a share, were issued to the holders of each share outstanding. An amount equal to the stated value of these additional shares was added to the capital stock account. A corresponding reduction was made in the capital surplus account so that it continued to express the difference between the issued capital stock and the amount stated as capital in the certificate of incorporation.[4]

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[4] Although the certificate of incorporation was amended it continued to provide that the "capital of the corporation shall not be less than" $113,043,675.

For purposes of comparison the capital stock and surplus accounts appeared as follows on January 1, 1921, December 31, 1921, 1924, 1931, 1936 and August 1, 1950:

	Jan. 1, 1921	*Dec. 31, 1921*	*Dec. 31, 1924*	*Dec. 31, 1931*	*Dec. 31, 1936*	*Aug. 1, 1950*
CAPITAL STOCK:						
Preferred Stock ..	$ 37,326,400	$ 38,951,700	$ 39,284,900	$ 39,284,900	$ —	$ —
Common Stock ...	10,717,275	10,847,195	10,890,545	12,006,440	12,006,440	44,281,290
Total	$ 48,043,675	$ 49,798,895	$ 50,175,445	$ 51,291,340	$ 12,006,440	$44,281,290
SURPLUS:						
Capital Surplus ..	$126,369,006	$ 63,244,780	$ 62,868,230	$ 61,752,335	$101,037,235	$68,761,695
Further Surplus .	—	59,414,300	78,419,869	103,416,917	69,073,984	(Not given)
Total	$126,369,006	$122,659,080	$141,288,099	$165,169,252	$170,111,219	$68,761,695

In 1950, Section 1800 of the Internal Revenue Code of 1939 imposed a tax on certificates of stock measured, as provided in Section 1802(a), as follows:

> "On each original issue, * * * of shares or certificates of stock, * * * *Provided further*, That where such certificates * * * are issued in a recapitalization, the tax payable shall be that proportion of the tax computed on such certificates * * * that the amount dedicated as capital for the first time by the recapitalization, whether by a transfer of earned surplus or otherwise, bears to the total par value (or actual value if no par stock)[5] of such certificates or shares issued in the recapitalization. * * *".

The appropriate regulation, Regulation 71, 26 C. F. R. § 113.23(e)(1) (1949) provides as follows:

> "Sec. 113.23—Rate and computation of tax.
>
> * * *
>
> (e) * * *
>
> (1) A tax is not payable with respect to stock issued in a recapitalization unless the recapitalization results in the dedication of an amount as capital which amount is so dedicated for the first time. Thus,

[5] The regulations, 26 C. F. R. § 113.23(c) state that "where stock has no par value, the rate of tax is determined by the actual value of each share * * *". The following provision of the regulations, however, seems to be the one under which the tax was computed:

> "(1) The actual value of stock not having a par value shall be determined on the basis of the market value of the stock at the time of issuance. If there is no ascertainable market value of the stock at the time of issuance, the actual value must be determined on the basis of all the facts and circumstances of the particular case." 26 C. F. R. 23(c)(1).

In the present case the tax was based upon the difference between the *stated* value of the shares and the stated value of shares previously issued as shown by the *capital* stock account. Neither party contends that the statute would require any other basis for determining the "actual" value of no par stock.

where a corporation transferred an amount from capital to capital surplus in a prior recapitalization, and such corporation in a subsequent or second recapitalization transfers such amount from capital surplus to capital under such circumstances that the amount so restored to capital is clearly identifiable, a tax is not payable with respect to the amount so rededicated as capital. However, the tax is payable with respect to a transfer of capital surplus to capital by way of a recapitalization where the amount so transferred had not been previously dedicated as capital. * * * [Regs. 71, 6 F. R. 6015, as amended by T. D. 5613, 13 F. R. 2407]."

Plaintiff claims that there was no dedication of capital whatever, that this was a mere stock split. The controversy turns on the meaning of the words "dedicated as capital" as used in the statute.

"Capital", in the sense of the original investment by the owners of a corporation, is usually shown in the capital stock account.[6] According to the type of stock, this is the aggregate of the par value or the stated value or the actual value of the shares issued. This account remains unchanged except insofar as the stockholders contribute additional funds to the corporation or withdraw their original investment from it. The fluctuation in the value of the business is not shown by a change in this account but rather by the fluctuations of the surplus account.

"Capital" in a less precise sense is also used to describe the proprietorship interest of the owners of the corporation at any given time. In this sense it is shown by the total of the capital stock and the surplus accounts. The surplus account may be derived from earnings or from amounts paid into the corporation from various sources, including contributions or payments by stockholders in excess of the amounts shown in the capital stock account. Capital in this sense, however, is not spoken of as "dedicated". Capital in

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[6] Kester, *Accounting, Theory and Practice*, 3d Ed., p. 344; Saliers, *Accountants' Handbook*, p. 1363.

this sense is simply the excess of assets over liabilities at the time in question.

It is my belief that the statute uses "capital" in the former sense, meaning the contribution of the stockholders to the corporation. In such a sense it is shown by the capital stock account.

Plaintiff, however, eschews the use of the word "capital" in either of these senses. It claims that the word must be used in whatever sense defined by the statutes of the state of a taxpayer's residence or incorporation. In the present case, it claims, this would be the $113,043,675, stated as "capital" in plaintiff's certificate of incorporation.

Viewed on the basis of accounting theory, this figure is completely artificial. It was based upon its *authorized* stock. It was and has always been unrelated to either the stated value or the actual value of plaintiff's issued stock or the stated or the actual value of the investment of the stockholders. It has always been equally unrelated to the tax paid upon plaintiff's stock, either in determining whether a tax should be paid or the amount of the tax.

Plaintiff protests that the New York statute provides that the capital of a corporation shall be the amount stated in its certificate of incorporation.[7] But although this amount

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[7] N. Y. Stock Corporation Law § 13 (formerly numbered § 23) states:

"§ 13. Capital

"For the purpose of any rule of law or of any statutory provision relating to the amount of the capital of a stock corporation, the capital of any corporation authorized to issue shares without par value shall be deemed to be an amount computed in accordance with the statements respecting its capital contained in its certificate of incorporation or other certificate filed pursuant to law, or in a special law creating the corporation; and the capital of any corporation not authorized to issue shares without nominal or par value shall be deemed to be the aggregate par value of its issued shares plus such amounts as, from time to time, may be transferred to capital by resolution of the board of directors."

may furnish a satisfactory basis for state regulation, for the protection of creditors, and for other state policies, it must not be used to distort the uniform application of a national tax. See *Burnet* v. *Harmel*, 287 U. S. 103, 110; *Lyeth* v. *Hoey*, 305 U. S. 188, 193; *United States* v. *Pelzer*, 312 U. S. 399, 402; *City Athletic Club* v. *United States*, Civil No. 24336, 2 Cir., March 8, 1957. See *Comm'r* v. *Estate of Bedford*, 325 U. S. 283, 292. Cf. *Rowen* v. *Commissioner of Internal Revenue*, 2 Cir., 215 F. 2d 641, 648. Here, the elementary nature of this term, the elementary sense in which it is used, its uniform meaning in the science of accounting, and its primary importance to the application of the tax, make it both unnecessary and unlikely that Congress intended to draw its meaning from varying state statutes providing for corporate regulation. Further, the artificial nature of the suggested state definition, which would measure capital in terms of authorized rather than issued stock, would require its rejection in the absence of an express mandate to refer to it. It could not be implied that Congress intended to incorporate so artificial a definition and one so likely to distort the application of the tax. The state definition suggested is not a refinement of a generally accepted meaning of the term "capital"; it is in conflict with its common meaning.[8] The state law must, of course, be understood in order to appraise the corporate transaction involved; see *Southern Pac. Co.* v. *Berliner*, N. D. Cal., 78 F. Supp. 696, 698, aff'd. 9 Cir., 176 F. 2d 671; *Rio Grande Oil Co.* v. *Welch, supra.*, 101 F. 2d 454, 456; *Cleveland Provision Co.* v. *Weiss, N. D. Ohio*, 4 F. 2d 408, 411; but that is not to say that identical transactions by corporations of different

[8] It is noteworthy that the term "capital", as so defined, is not used as the basis of any state tax. Where capital becomes significant for tax purposes the statute gives its own own definition of "capital". N. Y. Tax Law §§ 186, 208, or uses a substitute term, e.g.: "authorized shares" and "capital stock" § 180; "paid-in capital" § 182; or "capital stock" §§ 183, 184, 185. Section 182 which refers to foreign corporations uses "capital" in an altogether different sense because, of course, the N. Y. Stock Corporation Law would not be applicable to foreign corporations.

states, each showing a dedication of capital on the books of account, will be taxed differently because in one state a statute defines "capital" to mean something other than it would mean in general usage or in the usage of accountants.

Further, when it is appreciated that we are here dealing with a tax on shares or certificates as issued, not on capital as such;[9] and that the purpose of the proviso in question was simply to avoid the inequity of taxing as new shares those which, with respect to previously dedicated capital, merely superseded previously issued shares, which had already been taxed;[10] then it becomes clear that, regardless of how many meanings "capital" may have in other contexts, Congress intended for it to be defined here in the sense most closely identified with the shares or the certificates which were the subject of the tax, that is as measured by the capital stock account as kept in accordance with the usual practice of accountants.

This view is supported by the history of the controversy which, in 1947, resulted in the addition to the statute of the proviso in question. There was at that time no question but that a mere exchange of shares unaccompanied by an increase in capital was no basis for this tax.[11] The question arose, however, as to the tax to be imposed if there was an issue supported in part by previously dedicated capital and in part by new. *Rio Grande Oil Co.* v. *Welch*, 9 Cir., 101 F. 2d 454, and subsequently *Southern Pacific Co.* v. *Berliner*, 9 Cir., 176 F. 2d 671, held that in such cases

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[9] *United States* v. *National Sugar Refining Co.*, S. D. N. Y. 113 F. Supp. 157; *F. & M. Schaefer Brewing Co.* v. *United States*, E. D. N. Y., 130 F. Supp. 322. There have been periods when there was a concurrent tax on capital. Revenue Act of 1918, 40 Stat. 1057, 1126, 1133, 1135, 65th Cong., 3d Sess.; Revenue Act of 1939, 53 Stat. 169, 196, Part I, 76th Cong., 1st Sess.

[10] H. Rep. 969, 80th Cong., 1st Sess.; S. Rep. 713, 80th Cong., 1st Sess.; 1947 U. S. Code & Congressional Service 1683, 1684.

[11] Treasury Regulations 71, 26 C. F. R. § 113.23(e)(1); *Edwards* v. *Wabash Ry. Co.*, 2 Cir., 264 F. 610, 614; See *W. T. Grant Co.* v. *Duggan*, 2 Cir., 94 F. 2d 859.

the entire issue was taxable. *United States* v. *Pure Oil Co.*, 7 Cir., 135 F. 2d 578, held that only the proportion of the new shares equal to the proportion of new capital was taxable. By adding the present proviso Congress clarified the pre-existing statute in favor of the *Pure Oil* holding. See *Crown Cork & Seal Co., Inc.* v. *United States*, Ct. Cl., 94 F. Supp. 117, 120. Looking to the *Pure Oil* case for the test to be applied, its language in 135 F. 2d at p. 579 is:

> "The statute clearly indicates that, to be taxable, certificates must be, in point of time, the first issued, whereby the issuing corporation certifies ownership by its shareholders of their aliquot parts of the capital represented by the certificates."

Accordingly, the test is when did the corporation first certify *by issuing shares or certificates*, that its shareholders owned their aliquot parts of the capital represented by the certificates in question.

In the present case, the increase in the "capital" stated in the certificate of incorporation was unrelated to the issuance of shares. In point of time it actually followed the issuance of most of them. Plaintiff did nothing by way of issuing new shares or restating upon its books the value of the old which would show that corporate stockholders "owned their aliquot shares" of the new amount stated in the certificate of incorporation.

What plaintiff seeks to do is to escape a tax based upon the *issuance* of shares by pointing to a figure in its certificate of incorporation based upon its total *authorized* shares. If its contention were accepted all of its unissued stock would become eligible for issue tax-free. This would be a cynical parody upon Congress's intent. Congress sought to avoid the danger of a double tax. It did not intend for any corporation to escape the original tax. Plaintiff was not the object of Congress's protection because it had not, by stating its capital on the basis of its authorized rather than its issued shares, become liable for a tax or exposed itself to a double tax. Only by the actual issue of shares could there have been such an exposure.

Plaintiff's designation of a portion of its surplus account as "capital surplus" did not constitute a dedication to capital. Accountants frequently divide surplus into various subdivisions but the various subdivisions remain part of the corporate surplus, regardless of how they are titled. For example, by state law, dividends may be payable only from earned surplus as distinguished from paid-in surplus and the surplus account may be thus divided, but both divisions remain corporate surplus. There is no dedication to capital in an accounting sense merely because state law may prevent the free disposition of part of the surplus. In fact, plaintiff never classified its "capital surplus" as part of its capital accounts (see Exhibit B attached to stipulation of facts). It was treated as part of the surplus account; its total was consistently combined with that of "further surplus" to reach the amount of total surplus. It was never combined with the capital stock account to show in the balance sheet a figure as total capital which would correspond to the $113,043,675, stated as capital in the certificate of incorporation.

Further, the Treasury regulation which for several years has interpreted the proviso (Regulation 71, 26 C. F. R. § 113.23(e)(1) uses the term "capital surplus" as something clearly outside the concept of capital. It provides:

> "* * * Thus, where a corporation transferred an amount from *capital* to *capital surplus* in a prior recapitalization, and such corporation in a subsequent or second recapitalization transfers such amount from *capital surplus* to *capital* * * * a tax is not payable with respect to the amount *so rededicated as capital.*" (emphasis added)

Actually the so-called "capital surplus" is merely a paid-in surplus, part of the excess of the amount paid for the plaintiff's stock over the value of the stock stated on its books. It is entitled to no more favorable consideration than premiums frequently paid for par value stock. *United States Steel Corporation* v. *United States*, Ct. Cl. 142 F. Supp. 948, 952, held taxable an issue of stock based upon a "capital surplus" created from such premiums.

Plaintiff's final claim is that the capital underlying the recapitalization was merely a rededication of capital which had previously supported the preferred stock which was retired in 1936. This cannot be, because the capital which underlay the preferred stock was returned to the investors in cash when the stock was redeemed.[12] The capital stock was reduced not by transfer to capital surplus, as might occur if the stated value of the stock were reduced, but by redemption for cash. Although it did then become necessary to increase the capital surplus account to fill the gap between the shrunken capital stock account and the $113,043,675 stated as capital in the certificate of incorporation, this increase was made possible, as stated in the stipulation, by a transfer to capital surplus from further surplus, an account which has not in any sense ever been claimed to have been dedicated as capital.

Defendant's motion for summary judgment is granted. Complaint dismissed.

LAWRENCE E. WALSH

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United States District Judge

Dated: March 30, 1957.

Judgment entered

HERBERT A. CHARLSON
Clerk

3/30/57.

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[12] The stipulation of facts is incomplete; if the only book entries made were those described, the books would have been left out of balance. It does state, however, that the preferred stock was redeemed and cancelled and the consolidated general balance sheet (Exhibit B), shows that this was accompanied by a reduction in the cash account and by holdings in government securities. Therefore the entry which was omitted from the stipulation is a credit to cash in the amount paid for the redemption of the stock.

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FILED
AUG 20 1958
JAMES R. BROWNING, Clerk

No. 213

In the Supreme Court of the United States

OCTOBER TERM, 1958

ALLIED CHEMICAL & DYE CORPORATION, PETITIONER,

v.

DENIS J. McMAHON, Individually and as District Director of Internal Revenue for Lower Manhattan, New York

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
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OPINIONS BELOW

The opinion of the district court (Pet. 4a-16a) is reported at 156 F. Supp. 275. The *per curiam* opinion of the Court of Appeals (Pet. 1a-2a) is reported at 253 F. 2d 663.

JURISDICTION

The judgment of the Court of Appeals was entered on April 7, 1958. (Pet. 1a.) A petition for rehearing was denied on April 28, 1958. (Pet. 3a.) The petition for certiorari was filed on July 24, 1958. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the courts below erred in holding that stock issued by taxpayer in 1950 pursuant to a recapitaliza-

tion was subject to the documentary stamp tax imposed by Sections 1800 and 1802(a) of the Internal Revenue Code of 1939, as an original issue of stock.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Sections 1800 and 1802(a) of the Internal Revenue Code of 1939, and of Sections 113.20, 113.23 and 113.25 of Treasury Regulations 71 (1941 ed.) are set out in the Appendix, *infra*, pp. 7-11.

STATEMENT

The relevant facts, as stipulated (R. A13-A33) and as set out in the district court's opinion (Pet. 4a-16a), may be summarized as follows:

The taxpayer, a New York corporation, was organized in 1920. It issued preferred stock with a par value of $100 a share and no-par common stock with a stated value of $5 a share in a combined amount of $48,043,675. This amount was entered on its books in its capital stock account. (R. A13, A33; Pet. 5a-6a.) The capital stock account remained at approximately this amount until 1936 (R. A33) when the entire issue of preferred stock was retired, apparently by payment in cash (Pet. 6a-7a). The capital stock account was thereby reduced to $12,006,440, and remained at that figure (R. A33) until 1950, the time of the transaction here in question.

In 1950, the taxpayer, in a recapitalization, changed each of the 2,214,099 shares of no-par common stock, then issued and outstanding, into four shares of no-par common stock, resulting in a total of 8,856,396 shares issued and outstanding. (R. A17.) The certificates evidencing the shares outstanding were left unchanged.

New certificates evidencing the three additional new shares for each old share were issued to the stockholders. (R. A18.) This transaction was reflected on the books of the taxpayer by an increase in the capital stock account to $44,281,980, and a corresponding reduction in its capital surplus account. (R. A18.)

Since 1921, the taxpayer's surplus account has contained two items, a "Capital Surplus", showing an amount which, combined with the amount in its capital stock account, remains at $113,043,675, and a "Further Surplus", showing the balance of its surplus. (R. A33; Pet. 7a-8a.) The figure of $113,043,675 represents the value of the taxpayer's authorized capital as set out in its certificate of incorporation, as amended in 1921, on the basis of $100 for each of the then authorized 973,264 shares of preferred stock and of $5 for each of the then authorized 3,143,455 shares of common stock. (R. A14, A15, A21-32.) The then existing and since amended New York statute required corporations to state their capital on the basis of the stated value of their authorized stock rather than their issued stock. (Pet. 6a.)

A tax of $49,817.25 as the documentary stamp tax in respect of the issue of the additional shares in 1950 was collected; claim for refund was filed and disallowed, and this suit was brought. (R. A18-A19.) Both parties moved for summary judgment. The Collector's motion was granted; the taxpayer's denied. (Pet. 5a.) The district court held that the amount added to the capital stock account in the recapitalization was an amount dedicated to capital for the first time and that there was a taxable original issue of shares or certificates. (Pet. 5a-16a.) The Court of Appeals affirmed on the opinion of the district court. (Pet. 2a.)

ARGUMENT

This case presents a narrow question of federal tax law of no general importance, turning on the application of settled principles to the particular facts, and involving no conflict with the decision of any other Court of Appeals.

Section 1802(a) of the 1939 Code (Appendix, *infra*, pp. 7-8) imposes a stamp tax upon each "original issue", whether on organization or reorganization, of shares or certificates of stock (or of profits, or of interests in property, or accumulations) by any corporation. If the stock issued has a par value, the tax is imposed upon the par value. If the stock does not have any par, the tax is imposed upon the actual value of the certificates (or of the shares where no certificates are issued). Section 1802 was amended by Section 521 of the Act of August 8, 1947, c. 518, 61 Stat. 921, which added a provision that, where certificates were issued in a recapitalization, the tax payable on such certificates shall be limited to the "amount dedicated as capital for the first time" by the recapitalization, whether by a transfer of earned surplus or otherwise.

It has uniformly been held, both before and since the 1947 amendment, that upon a transfer of funds from a corporation's earned or surplus capital account to its capital stock account of amounts not shown to have been previously dedicated to capital, shares or certificates issued pursuant thereto are an original issue subject to tax. *United States Steel Corp.* v. *United States*, 142 F. Supp. 948 (C. Cls.), certiorari denied, 352 U. S. 1015; *Crown Cork & Seal Co.* v. *United States*, 94 F. Supp. 117 (C. Cls.); *W. T. Grant Co.* v. *Duggan*, 94 F. 2d 859 (C.A. 2d); *Rio Grande Oil Co.*

v. *Welch*, 101 F. 2d 454 (C.A. 9th). New stock issued to satisfy unpaid accumulated dividends is an original issue. *United States* v. *Pure Oil Co.*, 135 F. 2d 578 (C.A. 7th); *United States* v. *California Electric Power Co.*, 187 F. 2d 313 (C.A. 9th). The decision in this case, where there was a transfer from surplus to the capital stock account, with certificates issued accordingly, is squarely in line with those decisions.

The taxpayer contends that there was no dedication to capital in 1950 because, in effect, at the time of its formation in 1920-1924 all of its assets were dedicated to capital (Pet. 13), or, alternatively, because under state law it was obliged to maintain the amount of $113,043,675 as its authorized capital (Pet. 10). The first contention is in conflict with the uniform judicial and administrative interpretation of the applicability of the statute, with accepted accounting practices, and with the taxpayer's own accounting practices. The second contention would make the tax applicable to *authorized* capital rather than to the *issue* of shares or certificates, a construction of the statute directly contrary to its terms. The courts below properly rejected these contentions.

Moreover, there is no conflict of decisions. The decision in *Southern Pac. Co.* v. *Berliner*, 176 F. 2d 671 (C.A. 9th), the case upon which the taxpayer relies (Pet. 11-12), is in accord with the decision below in sustaining the taxability of shares issued upon a transfer from surplus to a capital stock account in a recapitalization. There the taxpayer corporation had outstanding, in 1940, a total of 3,772,763.0564 shares of capital stock of $100 par value, of which all but 210,157 shares were issued at par. The 210,157 shares were

issued at a premium of $6,304,845 over par. The corporation stock account was as follows (p. 672):

Stock	
Capital stock	$377,276,305.64
Premium on Capital stock	6,304,845.00
Total stock	$383,581,150.64

In 1940, the corporation issued to its stockholders in exchange for its par value stock an identical number of shares of no-par stock. It merged the two accounts in one capital stock account, transferring the amount in the premium on capital stock account into the capital stock account. The court held that this transfer was a dedication of additional capital and that the entire issue of no-par stock was an original issue, taxable in full. That case, in fact, goes farther than the present one in its imposition of the tax.

CONCLUSION

The decision below is correct. There is no conflict, and the question is not one of general importance. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Solicitor General.
CHARLES K. RICE,
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Attorneys.

AUGUST, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 1800. IMPOSITION OF TAX.

There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections.

(26 U.S.C., 1952 ed., Sec. 1800.)

SEC. 1802. CAPITAL STOCK (AND SIMILAR INTERESTS).

(a) [As amended by Sec. 521(a)(4), Revenue Act of 1941, c. 412, 55 Stat. 687, and Act of August 8, 1947, c. 518, 61 Stat. 921] *Original Issue.*—On each original issue, whether on organization or reorganization, of shares or certificates of stock, or of profits, or of interest in property or accumulations, by any corporation, or by any investment trust or similar organization (or by any person on behalf of such investment trust or similar organization) holding or dealing in any of the instruments mentioned or described in this subsection or section 1801 (whether or not such investment trust or similar organization constitutes a corporation within the meaning of this title), on each $100 of par or face value or fraction thereof of the certificates issued by such corporation or by such investment trust or similar organization (or of the

shares where no certificates were issued), 11 cents: *Provided,* That where such shares or certificates are issued without par or face value, the tax shall be 11 cents per share (corporate share, or investment trust or other organization share, as the case may be), unless the actual value is in excess of $100 per share; in which case the tax shall be 11 cents on each $100 of actual value or fraction thereof of such certificates (or of the shares where no certificates were issued), or unless the actual value is less than $100 per share, in which case the tax shall be 3 cents on each $20 of actual value, or fraction thereof, of such certificates (or of the shares where no certificates were issued): *Provided further,* That where such certificates (or shares, where no certificates are issued) are issued in a recapitalization, the tax payable shall be that proportion of the tax computed on such certificates or shares issued in the recapitalization that the amount dedicated as capital for the first time by the recapitalization, whether by a transfer of earned surplus or otherwise, bears to the total par value (or actual value if no par stock) of such certificates or shares issued in the recapitalization. The stamps representing the tax imposed by this subsection shall be attached to the stock books or corresponding records of the organization and not to the certificates issued.

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(26 U.S.C. 1952 ed., Sec. 1802.)

Treasury Regulations 71 (1941 ed.):

Sec. 113.20 [As amended by T.D. 5613, 1948-1 Cum. Bull. 133]. *Scope of Tax.*—Section 1802(a) imposes a tax upon each original issue of certifi-

cates (or shares when issued without certificates) of stock, or of profits, or of interest in property or accumulations by (1) any corporation, or (2) any investment trust or similar organization (whether or not constituting a corporation within the meaning of the Internal Revenue Code) holding or dealing in any of the instruments mentioned or described in section 1801 (see Subpart E) or section 1802(a), or (3) any person (such as a depositary) on behalf of such investment trust or similar organization. The tax applies to each original issue of the shares or certificates specified, irrespective of the purpose of the issue, the person to whom issued, or the time of delivery.

The tax also applies to shares or certificates issued in a recapitalization where the recapitalization results in the dedication of an amount as capital for the first time. However, in the case of shares or certificates so issued on or after August 8, 1947, the tax is subject to the limitation set forth in section 113.23(e).

Sec. 113.23 [As amended by T.D. 5613, *supra*]. *Rate and Computation of Tax.*—* * *

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(e) *Stock issued on or after August 8, 1947, in a recapitalization.*—Where stock is issued on or after August 8, 1947, in a recapitalization, the tax payable is that proportion of the total tax computed with respect to all the shares or certificates so issued that the amount dedicated as capital for the first time by the recapitalization, whether by a transfer of earned surplus or otherwise, bears to the total par value (or actual value if no par stock) of the shares or certificates so issued.

A tax is not payable with respect to stock issued in a recapitalization unless the recapitalization results in the dedication of an amount as capital which amount is so dedicated for the first time. Thus, where a corporation transferred an amount from capital to capital surplus in a prior recapitalization, and such corporation in a subsequent or second recapitalization transfers such amount from capital surplus to capital under such circumstances that the amount so restored to capital is clearly identifiable, a tax is not payable with respect to the amount so rededicated as capital. However, the tax is payable with respect to a transfer of capital surplus to capital by way of a recapitalization where the amount so transferred had not been previously dedicated as capital.

Where a recapitalization is effected in connection with, or as part of, some other transaction, for example—an original or an additional issue of stock; a merger; etc.—the limitation of the tax payable to the proportion specified in this subsection applies only to the stock issued in that part of the transaction which constitutes a recapitalization. Thus, where a corporation makes a change in its capital structure by replacing an issue of stock with another issue of stock and at the same time disposes of part of the new stock by sale to underwriters, the tax limitation is applicable only to that portion of the new stock which is issued in exchange for the old stock retired thereby. In such case, the portion of the new stock sold to the underwriters is taxable in its entirety without any adjustment on account of the recapitalization. Similarly, where a corporation retires its preferred stock by issuing common stock in exchange therefor, and such exchange is made in connection

with a merger in which the corporation issues common stock also to the former stockholders of the merged company, the tax limitation is applicable only to the common stock issued in exchange for the preferred stock, and the shares or certificates of common stock issued to the former stockholders of the merged company are subject to tax without any adjustment on account of the recapitalization.

Sec. 113.25. *Issues Not Subject to Tax.*—In addition to the various issues specifically exempt under section 1808, as to which see Subpart J, the following are examples of issues not subject to the tax:

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(f) The issue of stock in a recapitalization or reorganization where there is no dedication of additional capital, either by transfer of earned surplus or otherwise.

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